



Department of the Treasury
Internal Revenue Service
P.O. Box 2508
Cincinnati, OH 45201

Release Number: **202004012**
Release Date: 1/24/2020
UIL Number: 501.00-00, 501.03-11,
501.36-01

Date:
October 29, 2019
Employer ID number:

Contact person/ID number:

Contact telephone number:

Form you must file:

Tax years:

Dear :

This letter is our final determination that you don't qualify for tax-exempt status under Section 501(c)(3) of the Internal Revenue Code (the Code). Recently, we sent you a proposed adverse determination in response to your application. The proposed adverse determination explained the facts, law, and basis for our conclusion, and it gave you 30 days to file a protest. Because we didn't receive a protest within the required 30 days, the proposed determination is now final.

Because you don't qualify as a tax-exempt organization under Section 501(c)(3) of the Code, donors can't deduct contributions to you under Section 170 of the Code. You must file federal income tax returns for the tax years listed at the top of this letter using the required form (also listed at the top of this letter) within 30 days of this letter unless you request an extension of time to file.

We'll make this final adverse determination letter and the proposed adverse determination letter available for public inspection (as required under Section 6110 of the Code) after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in the Notice 437 on how to notify us. If you agree with our deletions, you don't need to take any further action.

We'll also notify the appropriate state officials of our determination by sending them a copy of this final letter and the proposed determination letter (under Section 6104(c) of the Code). You should contact your state officials if you have questions about how this determination will affect your state responsibilities and requirements.

If you have questions about this letter, you can contact the person listed at the top of this letter. If you have questions about your federal income tax status and responsibilities, call our customer service number at 1-800-829-1040 (TTY 1-800-829-4933 for deaf or hard of hearing) or customer service for businesses at 1-800-829-4933.

Sincerely,

Stephen A. Martin
Director, Exempt Organizations
Rulings and Agreements

Enclosures:

Notice 437

Redacted Letter 4036, *Proposed Adverse Determination Under IRC Section 501(c)(3)*

Redacted Letter 4038, *Final Adverse Determination Under IRC Section 501(c)(3) - No Protest*



Department of the Treasury
Internal Revenue Service
P.O. Box 2508
Cincinnati, OH 45201

Date:

September 3, 2019

Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

Legend:

B = Individual

C = Individual

E = Date

F = State

G = Organization

H = Individual

J = College

p dollars = Amount

q dollars = Amount

r percent = Percent

u percent = Percent

UIL:

501.00-00

501.03-11

501.36-01

Dear _____ :

We considered your application for recognition of exemption from federal income tax under Internal Revenue Code (IRC) Section 501(a). We determined that you don't qualify for exemption under IRC Section 501(c)(3). This letter explains the reasons for our conclusion. Please keep it for your records.

Issues

Do you qualify for exemption under Section 501(c)(3) of the Code? No, for the reasons stated below.

Facts

You were formed as a corporation on E in the state of F. Your Articles of Incorporation ("Articles") state that you are organized for charitable, religious, educational, and scientific purposes, including, for such purposes, the making of distributions to organizations that qualify as exempt organizations under Section 501(c)(3) of the Code.

Your Articles indicate that upon dissolution your assets will be distributed to Section 501(c)(3) organizations. Your Articles further states that after payment of debt, all money and other assets shall be given to G for student scholarships or to J. G and J are non-profit colleges. Your bylaws state that your board may not amend the

dissolution clause of your Articles which specifies that upon dissolution the assets of the corporation shall be distributed to G or J. It further states that the board may not amend or repeal the article regarding the directors and vacancies on the board or the actual article regarding amendments.

You describe your activities as acquiring a former church building to carry out your mission. After acquiring it, you invested substantial funds on renovations and repairs to the facility. The facility will be leased out to others to use including church organizations, a college, and for special events such as weddings, banquets, meetings, family reunions, concerts, etc. Space in the facility is leased to other entities for ongoing business activities. You will also permit several nonprofit groups to use your facility on a consistent basis for a reduced fee or for free, depending on their event.

H is your president as well as the president of G. G has entered into a long-term lease agreement with you for their ongoing business activities. In the future, you may pay G a management fee to oversee the day to day operations of your facility. You said you have a working relationship with G. You said that they are your anchor tenant and that the students from G are invited into planning, organizing, and planning events. You also say that you have coordinated, through business relationships, internship opportunities for the students. This is an occasional activity and is weekly, monthly, or quarterly. You said you spend very little time or money on these activities. You just provide space and opportunities.

B and C, husband and wife, are on your board. B and C loaned you p dollars with an annual interest rate of r percent to fund the renovation and remodel of the facility you purchased. The loan agreement indicated that the loan was to be repaid by a certain date, which was only months after it was signed. However, you began repaying the promissory note years before the agreement was signed.

You later obtained a bank loan for q dollars with an annual interest rate of u percent, which is about half the interest rate you were charged by B and C. Per the loan agreement with the bank, the loan was issued for the purpose of making additional improvements to your property, repay loans from individuals, and to provide funds for a payment reserve to be held in escrow. The agreement states that the escrow funds are only to be used for emergency purposes. The escrow will be used for monthly payments in the event of a funding shortfall due to the loss of a tenant or unplanned major expenses. The use of the funds must be approved by H and an officer at the bank.

You also provided a copy of the lease agreement between you and G, which was dated almost a year after the -year term of the lease began. The lease agreement was signed by H, as president of G, and B, as your representative.

Per your bylaws, so long as you are indebted to B and C, they will remain on your board or will have the authority to nominate candidates from which the board must select. Your bylaws also state that when G is no longer a tenant of the property you own and when you are no longer indebted to B and C for the development costs of the real property you own, new seats and vacancies of existing board seats may be filled by appointment of the board. Your bylaws further state that your initial directors shall consist of persons appointed by G and persons nominated by B and C or any entity controlled by them. of the initial directors (one nominated by G and one nominated by B and C) shall be appointed for a -year term and of the initial directors shall be appointed to a -year term.

You plan on utilizing the excess cash that is generated through leasing out the facility to provide college scholarships and grants for educational purposes and civic enhancement projects. You do not have a specific scholarship program in place at this time. You did not provide any information regarding the scholarship program you intend to have in the future.

You also provide your facility for community service projects. Before entering into a community service project partnership, you request a written, detailed plan including scope, funding, and beneficiaries to be submitted to the board for approval. To date, you have entered into project agreements with the several organizations to assist with program and community development. Most of the organizations use space in your facility periodically free of charge. You have not directed any funding, other than from the use of your facility, towards any of the activities listed.

Your revenues are almost exclusively generated from leasing your facility. You have three long-term lease agreements with three separate entities that conduct religious and/or educational activities. The revenues generated from those lease agreements make up approximately percent of your gross revenues. The remainder of your revenue is generated from leasing your facilities to anyone interested in the community for wedding events, corporate events, and other events.

Law

Section 501(c)(3) of the Code describes corporations organized and operated exclusively for charitable purposes no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Treasury Regulation Section 1.501(c)(3)-1(a)(1) states that, in order to be exempt as an organization described in Section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Treas. Reg. Section 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in Section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities in not in furtherance of an exempt purpose.

Treas. Reg. Section 1.501(c)(3)-1(c)(2) provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Revenue Ruling 58-547, 1958-2 C.B. 275, states that the lease of property under ordinary commercial arrangements does not constitute the exercise of an educational or charitable function in and of itself. Only when it is shown that the lease is for purposes substantially related to the exempt functions of the lessor does the above exception apply. The fact that the lessee may be an exempt educational organization does not cause the rental of space thereto to become a related activity on the part of the lessor who may be organized in part for educational purposes.

Rev. Rul. 69-572, 1969-2 CB 119, concluded that a nonprofit organization created to construct and maintain a building for the exclusive purpose of housing and serving member agencies exempt under Section 501(c)(3) of the Code is exempt under Section 501(c)(3). Because of the close connection between the organization and the

charitable functions of the tenant-organizations and the rental of the facilities at rates substantially below fair rental value, the organization furthers the charitable purposes of the tenants. The organization primarily relied on charitable contributions from the public and loans from charitable organizations to pay expenses and costs.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 179 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes.

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the court found that a corporation formed to provide consulting services was not exempt under Section 501(c)(3) because its activities constituted the conduct of a trade or business that is ordinarily carried on by commercial ventures organized for profit. Its primary purpose was not charitable, educational, nor scientific, but rather commercial. In addition, the court found that the organization's financing did not resemble that of the typical Section 501(c)(3) organizations. It had not solicited, nor had it received, voluntary contributions from the public. Its only source of income was from fees from services, and those fees were set high enough to recoup all projected costs and to produce a profit. Moreover, it did not appear that the corporation ever planned to charge a fee less than "cost."

In Living Faith Inc., v. Commissioner, 950 F.2d 365 (1991), the court of appeals upheld a Tax Court decision stating that the organization operated its restaurants and health food stores for a substantial commercial purpose and it did not qualify for exemption under Section 501(c)(3) of the Code. The appellate court provided the factors that may indicate a substantial nonexempt commercial purpose. These factors include:

- Direct competition with other for-profit businesses
- Existence and amount of annual and accumulated profits
- Competitive pricing policies and lack of below-cost pricing
- Use of promotional materials to enhance sales
- Advertising of goods and services
- Lack of plans to solicit charitable contributions, and
- Hours of operation that are competitive with other commercial enterprises.

In Airlie Foundation v. Internal Revenue Service, 283 F. Supp. 2d 58 (D.D.C., 2003), due to the commercial manner in which the organization conducted its activities, the court held that the organization was operated for a nonexempt commercial purpose, rather than for a tax-exempt purpose. The court found that the organization operated its conference center in a manner consistent with that of a commercial business. "Among the major factors courts have considered in assessing commerciality are competition with for profit commercial entities; extent and degree of below cost services provided; pricing policies; and reasonableness of financial reserves. Additional factors include, inter alia, whether the organization uses commercial promotional methods (e.g. advertising) and the extent to which the organization receives charitable donations."

Application of law

You are not operated exclusively for charitable, educational, or religious purposes under Section 501(c)(3) of the Code because your only purpose is to provide a facility for not only exempt organizations, but for anyone wanting to use it, for a fee. Because of this substantial non-exempt purpose, you fail the operational test under Treas. Reg. Section 1.501(c)(3)-1(a)(1).

You also provided a direct private benefit to your board members, B and C, by agreeing to a loan with an interest rate which was double the rate you later obtained from a bank. In addition, your bylaws ensured that B

and C would retain control of you or have authority to nominate candidates from which the board must select, so long as you are indebted to B and C. Charitable organizations cannot be operated to benefit insiders such as officers or directors as indicated in Treas. Reg. Section 1.501(c)(3)-1(c)(2). Your loan agreement and your structure substantially benefits the private interests of your founders, precluding you from exemption under Section 501(c)(3) of the Code.

More than an insubstantial part of your activities are dedicated to the non-exempt purpose of purchasing, remodeling, and leasing a property to any interested party, as evidenced by your financial information. You also said that in the future, you may enter into a management agreement with G for the management of your facility. At that point, it is not clear that you would have any direct activities; you would just hold title to a piece of property. Therefore, you are not operated exclusively for one or more exempt purposes as set forth in Treas. Reg. Section 1.501(c)(3)-1(c)(1).

You are similar to the organization described in Rev. Rul. 58-547. Even though you are leasing part of your facility to exempt organizations which conduct educational and religious activities, the leases are still ordinary commercial-type arrangements. Your only revenue is the lease payments you receive from your tenants and from individuals and/or organizations who are leasing your facility for weddings, community events, and corporate events.

You are distinguishable from the organization described in Rev. Rul. 69-572. In this ruling, the organization was found to be exempt under Section 501(c)(3) because they leased the space at rates substantially less than the general commercial rate and had a close relationship with the tenants, who were also exempt. In contrast, you are leasing your facility to your tenants at amounts that cover all the costs involved in renovating and leasing the facility. In addition, you have no stated involvement in the programs of your tenants, other than providing space, showing there is no relationship between your purposes and your tenants' purposes.

As stated in Better Business Bureau of Washington, D.C., Inc., the presence of a single nonexempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes. Community organizations are periodically granted use of space in your facility at reduced rates or free of charge. However, this is not a substantial purpose. Your operations are almost exclusively dedicated to leasing your property to a variety of organizations, both exempt and non-exempt, and individuals. This substantial nonexempt purpose precludes exemption under Section 501(c)(3).

Purchasing, renovating, and leasing a facility are not inherently exempt activities. Similar to the organization in B.S.W. Group, Inc., your revenue consists only of rental income and your expenses are dedicated to the support and operation of your facility. There is no indication you will charge a rental fee that is below cost. Although you do allow community groups to meet in your facility free of charge, that is not your purpose. Also, even though some religious and educational activities are conducted in portions of your facility, you do not conduct those activities. Your activities consist of leasing your facility and collecting rent, which is a business that is ordinarily carried on by commercial ventures organized for profit.

You are similar to the organization described in Living Faith Inc., who was denied tax exemption due to the commercial nature of their operation. Your rental activity is indistinguishable from an ordinary business. The fact that this activity accounts for all of your revenues and expenses shows this is a substantial purpose, precluding you from exemption under Section 501(c)(3) of the Code.

You are operated for a substantial nonexempt purpose like the organization described in Airlie Foundation. Applying the factors stated in this case, your provision of a facility primarily for a fee directly competes with other providers of similar services. Like an ordinary business, your services are generally available to any individual or organization willing to pay your fees. Because of this demonstrated substantial nonexempt purpose, you are not exempt under Section 501(c)(3) of the Code.

Conclusion

Based on the facts and circumstances presented, we conclude that you do not qualify for exemption under Section 501(c)(3) of the Code. A substantial portion of your activities include renovating, maintaining, and making your facility available for lease to any interested party. These activities constitute a substantial nonexempt purpose and are indistinguishable from those of ordinary nonexempt enterprises. Additionally, your loan agreements and related arrangements with insiders provide a substantial private benefit. Therefore, you are precluded from exemption under Section 501(c)(3).

If you agree

If you agree with our proposed adverse determination, you don't need to do anything. If we don't hear from you within 30 days, we'll issue a final adverse determination letter. That letter will provide information on your income tax filing requirements.

If you don't agree

You have a right to protest if you don't agree with our proposed adverse determination. To do so, send us a protest within 30 days of the date of this letter. You must include:

- Your name, address, employer identification number (EIN), and a daytime phone number
- A statement of the facts, law, and arguments supporting your position
- A statement indicating whether you are requesting an Appeals Office conference
- The signature of an officer, director, trustee, or other official who is authorized to sign for the organization or your authorized representative
- The following declaration:

For an officer, director, trustee, or other official who is authorized to sign for the organization:

Under penalties of perjury, I declare that I have examined this request, or this modification to the request, including accompanying documents, and to the best of my knowledge and belief, the request or the modification contains all relevant facts relating to the request, and such facts are true, correct, and complete.

Your representative (attorney, certified public accountant, or other individual enrolled to practice before the IRS) must file a Form 2848, Power of Attorney and Declaration of Representative, with us if they haven't already done so. You can find more information about representation in Publication 947, Practice Before the IRS and Power of Attorney.

We'll review your protest statement and decide if you gave us a basis to reconsider our determination. If so, we'll continue to process your case considering the information you provided. If you haven't given us a basis for reconsideration, we'll send your case to the Appeals Office and notify you. You can find more information in Publication 892, How to Appeal an IRS Decision on Tax-Exempt Status.

If you don't file a protest within 30 days, you can't seek a declaratory judgment in court later because the law requires that you use the IRC administrative process first (IRC Section 7428(b)(2)).

Where to send your protest

Send your protest, Form 2848, if applicable, and any supporting documents to the applicable address:

U.S. mail:

Internal Revenue Service
EO Determinations Quality Assurance
Mail Stop 6403
P.O. Box 2508
Cincinnati, OH 45201

Street address for delivery service:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Mail Stop 6403
Cincinnati, OH 45202

You can also fax your protest and supporting documents to the fax number listed at the top of this letter. If you fax your statement, please contact the person listed at the top of this letter to confirm that they received it.

You can get the forms and publications mentioned in this letter by visiting our website at www.irs.gov/forms-pubs or by calling 800-TAX-FORM (800-829-3676). If you have questions, you can contact the person listed at the top of this letter.

Contacting the Taxpayer Advocate Service

The Taxpayer Advocate Service (TAS) is an independent organization within the IRS that can help protect your taxpayer rights. TAS can offer you help if your tax problem is causing a hardship, or if you've tried but haven't been able to resolve your problem with the IRS. If you qualify for TAS assistance, which is always free, TAS will do everything possible to help you. Visit www.taxpayeradvocate.irs.gov or call 877-777-4778.

Sincerely,

Stephen A. Martin
Director, Exempt Organizations
Rulings and Agreements